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[ WHAT IS MANAGEMENT AUDITING ]

by

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The term management auditing is usually used in the sense that it is a definable operation with recognizable boundaries. Also, it is common to use the term to try to refer to auditing that somehow goes beyond financial operations.

To help analyze this question, I would like to throw out some general propositions on the role of auditing in today's increasingly complex environment where everything seems to be big--as well as complex--big government, big business, big labor, big problems.

- First, all auditing is an evaluation of someone's performance. This is true irrespective of labels which may be applied in an effort to draw distinctions between audits. These labelling efforts, which result in such terms as financial auditing, management auditing, operational auditing, program auditing and a host of others, are seldom very successful in conveying precise meanings.
- Second, the full scope of the auditor's job embraces examinations of
  1. Financial operations, including the handling of funds and other resources, checking compliance with applicable laws and regulations, and properly accounting for and reporting on the custody and use of resources.

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2. Whether funds and resources are managed efficiently and economically, and
3. Whether operations are effective, that is, whether or to what extent the objectives established for the activity are being achieved.

Since a scope of audit as broad as this encompasses the full range of management activity--irrespective of whether the organization is in the public sector or in the private sector or somewhere in between--all auditing is an audit of management and therefore can properly be labelled "management auditing."

I make this observation to emphasize the point that the conduct of financial transactions, accounting for them properly, and reporting on the results and status properly are integral parts of management responsibility and any label of management auditing that excludes them is just plain wrong.

- My third proposition is that to be most effective, all auditing has to be conceived, managed and regarded as a constructive component of overall management, rather than a negative and critical function that acts more as a barrier to efficient and effective operations, than as an essential method of promoting improvements.

Having stated these propositions, I could elaborate on each of them at length in conceptual terms. However, I believe it would be more useful to review a few specific cases drawn from the work of the U.S. General Accounting Office with which I am associated to illustrate the range of management concerns with which the independent auditor may be associated.

#### SCOPE OF GAO AUTHORITY

Our basic audit charter, which was set forth 55 years ago in the Budget and Accounting Act of 1921, is to investigate all



matters relating to the receipt, disbursement, and application of public funds in the Federal Government. This language was deliberately stated in broad terms and imposes no limits as to the scope of our auditing and investigative work.

Over the years, the Congress has restated the scope of our audit authority in different terms, however. For example, in the Legislative Reorganization Act of 1970 and the Congressional Budget and Impoundment Control Act of 1974, the Congress highlighted the role that our audits of Government program results can play in support of its oversight and legislative functions. The 1974 language specifically requires the Comptroller General to "review and evaluate the results of Government programs and activities when ordered by either House of Congress, or upon his own initiative, or when requested by any committee . . . having jurisdiction over such programs and activities."

This kind of legislative action underscores the emphasis on advanced auditing that the Congress--as an oversight body in our Government--wishes the GAO as one of its arms to specifically recognize.

#### REPORTING

The results of GAO audit work are reported in a variety of ways: in written reports addressed to the Congress, committees



and Members; in reports addressed to agency officials; in congressional testimony; in oral presentations to and discussions with Members and their staffs, staffs of the committees, and agency officials; in the annual reports of the Comptroller General; in periodic publications, such as the monthly list of GAO reports, summarizing information on GAO activities.

#### SOME SPECIFIC CASES

We complete in the neighborhood of a thousand reports a year on the vast variety of programs and activities of Federal agencies. For this reason, I won't represent the examples selected for discussion here as necessarily representative of GAO audit work. But they do illustrate to some degree the variety of activities reviewed, the scope of audit work performed, and the effort to be constructive and produce useful information for Federal managers, policy-makers, and the Congress which we directly serve.

#### Air Conditioning of Military Housing in Hawaii

My first example pertains to how the auditor can be instrumental in helping to avoid unnecessary expenditures of public funds. A result such as this is probably one of the most financially constructive contributions that an auditor can make-- at least from the standpoint of the general taxpayers.



The case concerns air conditioning in the State of Hawaii-- the subject of one of our audits nearly two years ago.

The Department of Defense had specified that all existing and future family housing in Hawaii would be air-conditioned. This was to be an across-the-board requirement. We examined this proposed program because of the expected high cost of installation and later maintenance and operation and because of the increased use of energy that would result.

We estimated that the costs of installing such facilities might run as high as \$100 million and annual operating and maintenance costs would increase by millions of dollars. We concluded that a blanket policy of centrally air-conditioning all military family housing units in Hawaii was unnecessary for several reasons:

- First, the requirement for air-conditioning did not consider the cooling effect of trade winds and the consistently moderate temperature and humidity conditions which gives Hawaii one of the most pleasant climates in the world.
- Second, central air conditioning is not common in Hawaiian townhouses and private homes and, generally, it is not essential to the health, welfare, or morale of persons living in Hawaii.
- Third, the military services themselves, as distinct from the Department of Defense in Washington, as well as other Federal agencies in Hawaii do not believe that air conditioning is needed, except at some locations with unusual weather or noise problems.



We also felt that across-the-board installation of central air-conditioning would aggravate Hawaii's energy problems. This point is of especial interest in these days of growing shortages of energy sources. Hawaii has been one of the States most affected by the supply and cost problems related to oil consumption. Almost all of Hawaii's electric power is produced from imported oil.

Our report\* to the Congress prompted some newspaper headline writers to say things like:

"Air-Conditiong Proposal Given Cool Reception" and

"Cooling Hawaii Homes Leaves Probers Cold".

But, more important, it also generated some interest on the congressional front. Senator Roth of Delaware was especially concerned and he introduced an amendment to the military construction authorization bill to prohibit using any appropriated funds for such a purpose. His amendment was adopted.

As a result of this action, we estimate that there will be a nonrecurring saving in expenditures of about \$56 million and a recurring savings in current operating costs of about \$9 million a year. These amounts do not loom large in a Federal budget of around \$400 billion a year--but how many people in your salary brackets would have to pay taxes to finance such a program

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\*"DOD's Requirement for Air-Conditioning Military Family Housing In Hawaii is Unnecessary", B-172376, 5/20/74



if it had gone through?

This example shows how the auditor can have an important impact if he presents his findings clearly and promptly and the issues are current. In this case, the combination of budgetary and energy aspects generated prompt and effective attention. This example also illustrates that reviewing of proposals--before they are put into effect and expenditures made--can be more productive of desirable financial impact than the examination of expenditures after they have been made.

#### Urban Rats

My next example is concerned with a much different subject and from the standpoint of what is accomplished with money spent. It also concerns a somewhat disagreeable subject but one that needs attention and effective action.

The subject is rats. Their existence anywhere is something to be concerned about because of their destructive and disease-carrying abilities.

But in our inner cities, they have become a symbol of urban blight. They contaminate food--they damage buildings with their gnawings--they outrage or frighten people whose paths they cross--and they often attack young and old people.



The Department of Health, Education, and Welfare has estimated that there are 100 million rats in the U.S.--about 1 for every 2 people. And it has estimated further that rats cost us about \$1 billion a year in direct economic losses.

Several years ago, the Federal Government started a control program based on making grants of funds to local government and private agencies to stimulate comprehensive rat control programs. About \$85 million was granted through 1974 for projects in 59 communities serving about 7 million residents.

The goal sought to be achieved through this program has been quite simple--to reduce rat populations and change the conditions they like to live in so that they are no longer a significant detriment to the health and economy of the target area.

Progress in the program is measured by the reduction in the number of confirmed rat bites per year and by the increase in the number of city blocks that have met certain sanitation standards.

Last year, GAO reviewed this program and its accomplishments and concluded simply that it was in trouble. We did observe and report\* that some progress had been made as indicated by such things as:

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\*"The Urban Rat Control Program Is In Trouble", MWD-75-90, 9/29/75



- A 54 percent reduction--from 710 to 330--in the annual number of confirmed rat bites in the 20 cities originally in the program.
- A steady increase in the number of city blocks where rat control was considered effective, and
- Greater public and local government understanding of the rat problem and what actions were needed to solve it.

However, we also pointed out that despite these indications of progress, it was doubtful if the goals of the program were going to be achieved. For example,

- The number of city blocks with effective control was far short of the targets that had been established.
- There were indications that some projects were unable to sustain the improvements they had achieved.
- Many cities reduced their rat control efforts--for lack of enough money.
- The measurements of accomplishments themselves are subject to question.
- In some places, sanitation codes were either inadequate or were not being enforced.
- Effective community support was lacking--and without this no program of this kind can possibly succeed.

We made a few recommendations aimed at improving the program. But it seems obvious that solving a problem like rats requires a very strong local commitment and vigorous and sustained local effort--by those in authority--by property owners--and by residents.



The Federal department involved in this program is concerned that the program must be made more effective. However, it looks to itself as a stimulator of an activity that should be the primary responsibility of State and local governments. The Congress has displayed some interest as evidenced by the fact that representatives of the GAO testified before a congressional committee on our report a few months ago.

I mention this particular examination because it illustrates not only operating problems where more than one level of government is involved. It also illustrates that auditors can bring an independent viewpoint to bear and produce a report that can focus public attention on a serious nationwide problem, perhaps better than any other medium. The purpose of such auditing is constructive--to evaluate performance, provide oversight information for the Congress which authorizes and appropriates public funds for such programs, and to suggest improvements in management and procedures to obtain better results on a social and economic program with such highly desirable objectives. Whether in this program real improvement will come about remains to be seen.

#### Grain Inspection

A subject that has been much in the news during the past year is the sorry state of our national grain inspection system--



a system that has been organized and operated in such a way as to permit not only dishonest practices in attesting to the quantity and quality of grain inspected but also extensive bribery. We still read almost weekly of criminal indictments being handed down and convictions of individuals for wrongdoing.

The production and sale of grain is big business. Crops in our country in 1974, for example, produced over 9 billion bushels of grains--mostly wheat and corn--worth about \$33 billion. About a third of it was exported.

Last month, GAO completed an extensive examination of the grain-inspection system at the specific request of two congressional committees--one in the House and one in the Senate.

The study was a far-ranging one and only a few highlights can be touched on here. For example--

- The Department of Agriculture has the job of providing overall supervision of the national grain inspection system. However, it has not been able to insure the integrity of the system which is operated by a widely dispersed group of over 100 State and private agencies and trade associations.
- Some inspection services have been satisfactory but the system has operated without effective controls, procedures, or lines of authority and conflicts of interest between grain inspection on the one hand and merchandising operations on the other have been tolerated.



- Weaknesses in the system have led to extensive criminal abuses such as intentional misgrading of grain, shortweighing, and using improperly inspected carriers.
- Foreign buyers of U.S. grain have lost confidence in our system because of misgrading and shortweighing. Some have turned to other countries when possible as their source of supply (GAO auditors interviewed grain buyers in nine foreign countries as part of the examination).
- The effectiveness of the Department of Agriculture's supervision has been limited because the system was designed in the first place to facilitate grain marketing rather than assure integrity of all transactions.

Also, important was the fact that the Department has not had enough people to do a good job (a common problem in Federal programs). But even where it became aware of weaknesses, the Department did not take aggressive action to correct them or even determine how extensive the problem was. Also, it did not establish what actions were to be taken when grading, sampling, or other inspection irregularities occurred.

GAO's main conclusion from all this was that fundamental changes were needed in the grain inspection system. Our solution which we recommended was that the Congress establish a Federal system of inspection with the costs of Federal inspection services to be reimbursed to the Federal Government. In this way, there would be no increase in net Federal expenditures but a stronger and more reliable system should result.

The GAO report also presented related additional recommendations that should be considered in switching over to a Federal system.



What will happen is still being debated. In some quarters, the idea of a Federal system is strongly endorsed, but in others it is opposed.

The Comptroller General and members of the GAO staff who participated in this examination testified on our findings before the Senate Committee on Agriculture and Forestry on February 20. Members of this Committee were favorably impressed with the report which they characterized as "the most thorough investigation of our grain marketing and inspection system ever undertaken."

For anyone who is interested in an outstanding example of the kind of light auditors can shed on a complex problem of national concern involving Federal and State Governments, farmers, private industry, trade associations, and foreign interests, this GAO report\* is as good as any to be found.

#### Small Business Loans

My next example is concerned with the lending of Federal funds.

The Small Business Act authorizes the Small Business Administration of the Federal Government to guarantee as well as make direct loans to small businesses. Over 80,000 of these loans totalling nearly \$4 billion are outstanding.

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\*"Assessment of the National Grain Inspection System," RED-76-71,  
2/12/76



A recently completed GAO audit of this program brought to light a lot of problems that require aggressive management attention if it is to more closely achieve the objectives for which it was established, including some protection of the general taxpayer. These problems included such defects as:

- Approving loans which merely transferred the risk of obtaining repayment from banks and creditors of the borrowers to the Federal Government.
- Questionable refinancing of loans to borrowers who were already delinquent in their payments and appeared to promise little chance for improvement.
- Making loans to wealthy businesses who were never intended to receive such assistance.
- Failure to analyze prospective borrowers' financial condition adequately or verify adequacy of collateral pledged.
- Not detecting borrowers who used the proceeds of their borrowings for unauthorized purposes.
- Failure to routinely visit borrowers to check on their progress.

Other problems were identified in the GAO report\* but those mentioned above are enough to illustrate the general finding that a lot of tightening up was needed. Government lending programs are usually difficult to manage and control because the borrowers are usually those who cannot get suitable credit from private

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\*"The Small Business Administration Needs to Improve Its 7(a) Loan Program", GGD-76-24, 2/23/76



sector sources and are therefore much more risky. At the same time, the Congress in authorizing the programs, usually fixes reasonable assurance of repayment as a condition for making loans. This in turn is reasonable since any other criterion would amount to almost a "give-away" program and these are seldom acceptable except for welfare purposes.

Another problem besetting the small business loan program--and noted in the grain inspection example--was the lack of adequate staff to do a better job. Auditors do well to point out such circumstances where they account--at least in part-- for unsatisfactory performance. Government administrators seldom set out to do an inadequate job. In many cases, they are caught between having heavy workloads with inadequate staffs--both in numbers and capability--to do a good job.

Auditors can do a disservice to the objectives they serve and to their profession by not recognizing that even where management problems exist there are bright spots to report. The GAO report on the loan program of the Small Business Administration did take note of the constructive assistance the agency had provided to many small businesses and the good quality of its stated procedures for administering its loan program. The problems identified were mainly problems in the way the procedures were carried out.



In commenting on the report, the agency expressed appreciation for the overall tenor of the report, acknowledged the managerial shortcomings described, and described what it intended to do about them.

This case illustrates the constructive job an independent auditor can do in stimulating better government operations (to the taxpayers' benefit) including providing good, solid information to the Congress for its use in legislative oversight.

The report not only went to the Congress but public hearings were held on it by the Senate Select Committee on Small Business immediately and this kind of attention always stimulates better management performance--at least for a time.

Another important segment of our audit of the Small Business Administration pertains to its accounting and the reliability of its financial statements. The results of this work are now being reported to the Congress.

One aspect of this work involved our auditors in making judgments on whether the agency should include in its accounts an estimate of the possible losses it may sustain in the future after it took over loans it had guaranteed. We concluded that they should and so reported although the agency disagreed.



The issue is of current importance in the light of Statement of Financial Accounting Standard No. 5 on accounting for contingencies published by the Financial Accounting Standards Board about a year ago.

#### Other Examples

The scope of operations of the Federal Government are so vast and wide-ranging that GAO as the independent auditor for the Congress finds itself examining management and operational performance in almost every category of human endeavor. Here are a few shorter examples:

1. We all use the U.S. mails. Last year the Federal Government itself spent about \$440 million on postage. We found that a large part of this cost could have been cut through use of more economical mailing practices such as
  - Using less expensive classes of service.
  - Cutting down on special mail services such as special delivery, insured, and certified mail.
  - Using letter-size envelopes instead of the most costly "flats" or large-size envelopes.

The postage cost paid of \$440 million related to nearly 3 billion pieces of mail. The GAO study\* did not get into how much of that was unnecessary mailing in the first place and that in itself could be a fruitful examination.

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\*"Federal Agencies Could Do More To Economize on Mailing Costs", GGD-75-99, 8/25/75



One example--during 1974 the San Francisco Mint mailed nearly 3 million announcements to advertise the availability of its coins to prospective purchasers. All of these announcements went by first-class mail. Had they been sent third-class, the postage costs would have been about \$500,000 lower. Mint officials told us, in effect, that the lower preferential treatment of third-class mail and its "junk mail" image would be detrimental to their program. But they did agree to check further into the matter.

The findings in this examination are potentially applicable to any organization and auditors should be alert to such possibilities. One of the most valuable functions of the auditor is to call attention to and question practices that have been accepted but which result in waste of resources. No institution can survive indefinitely without regard to efficient use of resources. Auditors have an important part to play here and--wherever located organizationally or functionally--they should contribute as best they can.

2. It is national policy that public buildings financed with Federal funds be designed and constructed to be accessible to the physically handicapped. This policy is set forth in the Architectural Barriers Act of 1968.

A GAO review of the impact of this law, reported to the Congress in last July, brought to light the fact that the law has had only a minor effect on making public buildings barrier free.\* In making this review, GAO auditors inspected over 300 buildings or building plans in 35 different States and the report described in some detail the kinds of problems found.

The overall conclusion was that tighter legislative requirements were needed. The report recommended such legislation and, to make it easy for the Congress to pursue, included specific language to accomplish the purpose. This can be a fruitful technique.

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\*"Further Action Needed To Make All Public Buildings Accessible To The Physically Handicapped", FPCD-75-166, 7/15/75



3. Auditors cannot escape computers in this day and age. Computer technology is widely used in government operations--at all levels. It is needed but it is costly. Constant vigilance is needed if costs are to be kept at a minimum and still make the fruits of the technology available.

Last year, GAO reported on its study of the possibility for large savings in acquiring computer systems under Federal grant programs.\* This is a case where the Federal Government has a good, strong policy--at least the Office of Management and Budget and the General Services Administration have stated one. But as in the case of all policies, stating them is one thing and having them properly carried out is another. This is where auditors can be helpful.

In this case, the GAO report described how, under existing administrative arrangements, grantees were being allowed to do such things as--

- Obtaining new computer systems or adding to the ones they already had without thoroughly evaluating their needs.
- Obtaining their own systems without fully exploring possibilities of joint use of existing facilities with other organizations.
- Leasing computer equipment for short periods without fully considering the financial benefits of purchasing or long term leasing.

While effective surveillance over operations of recipients of Federal grant funds is not the easiest thing to accomplish in our system of complex intergovernmental relationships, the types of problems we found illustrate the need for much stronger procedures to help save that scarce resource--namely, Federal (that is, national taxpayers') funds.

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\*"Opportunity For Savings Of Large Sums In Acquiring Computer Systems Under Federal Grant Programs", FGMSD-75-34, 7/24/75



An auditor cannot directly correct problems that he sees. But he can recommend actions he thinks will help correct them. In this case, our report included several specific recommendations designed to help insure that grantees follow business-like practices in acquiring computer equipment.

There are many other fields that GAO auditors operate in but all I can do here is provide a few samples to illustrate their work.

#### GAO'S ROLE

GAO occupies a unique position in the Federal Government's scheme of organization and checks and balances. Our independence as auditors of Federal operations is enhanced by several factors, including these:

- We are located in the legislative branch of the Federal Government in which authorization, financing, and oversight responsibilities for most Federal activities are lodged.
- We have been given a very broad charter of authority and responsibility in several laws enacted by the Congress.
- We are headed by two officials who are appointed for 15-year terms.

These factors have enabled us to make a great deal of progress in expanding the scope of our audit operations.

Our relative independence of operation and performance has helped lead to a considerable broadening of the audit function in other levels of government and outside government. In



short, the scope of GAO audit work and our published code of auditing standards are helping to serve as beacons for other governmental audit organizations.

We think that State and local governments can definitely benefit from an advancement in the nature and scope of the audit work performed by them or on their behalf and that such advancement can only inure to the benefit of those who contribute a share of their income and resources through taxes to finance government operations.

And--to conclude--that's what auditing of government operations is all about--evaluating how good a job is being done with public resources.